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Consumer extreme (over)indebtedness. An Spanish Law approach

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1. ***Facing problems that arise from consumer extreme indebtedness***

For a long time, consumer over-indebtedness has been creating a major problem in most of European countries. This issue has so many implications that it goes beyond the perspective of the individual consumer, and becomes a "social problem". Although common data does not exist, and each country faces up to the situation depending on its own national development of the retail credit market and of its own legal system, the over-indebtedness problem affects a whole range of consumers, regardless of their nationality, their income level, their age and social status.

Many diverse influences cause this problem. Sometimes, over-indebtedness is brought about by casual and non-predictable contingencies that reduce consumer income (unemployment, illness, etc). It can also be caused by an imprudent household management, a non-realistic life style or by false expectations on the real likelihood to come out of present debts. The real danger of complete insolvency is realized when the financial source of revenue collapses, with consequences that may become fatal to the consumer, to its family, to its creditors and to society as a whole.

The above-mentioned situation calls for the adoption of measures in the EU. Firstly, as a new perspective of consumer protection, historically faced by the European Community as a branch of the internal common market. Secondly, as an issue capable of affecting the common internal credit market. A real internal credit market cannot be imagined without a common set of rules provided to this purpose. As in many other cases, the consumer would be prevented from getting credit abroad, if there are incongruities and divergences between legal systems, making unclear whether the alien legal system provides a legal framework similar to the national and knowable body of law. As stated by the Economic and Social Committee (April 2002) in "The extreme household indebtedness", two fundamental rationales exist in order to legitimate a common regulation in this subject matter: levelling an equal competition standard for all creditors and credit intermediaries, and making possible the functioning of the internal market as well. Should be this market a real "common" market as to the possibilities of offering and taking retail credit, it cannot be shared afterwards by providing different legal solutions to the extreme indebtedness that may be brought about inside this market, and even by the functioning of this market possibilities. Without legal harmonisation, new barriers of and new distortions to the competition may appear.

2. ***The concept of over-indebtedness***

The most outstanding question to be solved is that related to the core of the problem: when can be said that a consumer is over-indebted? Should the answer depend on the case-by-case policy intended by the rule? There are no conceptual problems when the consumer insolvency becomes definitive, comparing the net assets and the actual, mature and payable, debts that overcome them. Notwithstanding, it remains a legal policy to widen this concept, to comprise also situations of feared insolvency, imminent breakdown of payments and prospective asymmetries between the future stream of expected revenues and the secure flows of duties to be matured.

In addition to the above-mentioned difficulties, we should not forget that many kinds of consumer debts consist on contractual and legal duties whose creditor is also a consumer creditor. Especially worth mentioning are family child support debts and alimony debts arising out of separation and divorce proceedings. These legal duties can be put in danger when the debtor engages in an imprudent indebtedness race.

An indebted consumer is a person who ought to save part of its personal or familiar budget in order to face the payment of consumer past debts that were contracted under instalment credit. An indebted consumer is never a "cash" consumer, but a "credit" consumer. Without consumer credit (i.e, actual advances for non-commercial purposes, which must be paid in the future), the present problem does not take place. However, where should we set up the boundary between indebtedness and over-indebtedness? There are two possibilities. Taking an objective approach, over-indebtedness appears when the amount of debts exceeds an economic threshold. Nevertheless, this approach does not take into account the real divergences in personal/familiar incomes among different people and leaves out of consideration the personal circumstances of the debtor (i.e, a single professional opposite a lower class family with unemployed members, etc). A subjective approach takes into consideration the real financial difficulties and focuses the present impossibility to face financial duties, though future, whichever the cause or the debt's amount may be.

In the German *Insolvenzordnung*, insolvency proceedings are ordered when the debtor is not capable of paying; this incapacity may be present or future; there is a presumption that incapacity exists whenever the debtor fails to perform a matured debt. On the other hand, French law defines the over-indebted consumer as a person that in good faith faces the manifest impossibility to pay the whole of its non-professional present and future debts (Art. 331-2 *Code de la Consommation*).

Consumer creditors "surf" mainly upon the cash flow. The real possibility to face up to the stream of debts depends, in every situation, on the flow of personal incomes of the consumer (salary and other minor grounds of periodical revenues). Assuming that the most valuable personal asset – the home – is normally encumbered to secure the mortgage creditor who advanced the credit necessary to buy this asset, the present and future personal cash flow sets an irretrievable limit to the seizure of assets in order to pay creditors who do not owe security rights. This cash flow stream poses also the rationale of the over-indebtedness regulations as well. Non-secured creditors have no real chance of success through promoting insolvency proceedings against the

bankrupt debtor. There are normally no assets for sale, but an intangible and non-accountable capacity to earn. Therefore, they have real incentives to compromise with the consumer commitment to keep intact its capacity to generate future earnings. A realistic policy would be to secure a real possibility to recompose and reconstruct the family household with this future flow. The "fresh star" benefits the debtor, but also allows creditors to make future advances or collect later their past credits. Beyond the future flow of personal revenues, creditors cannot find anything else to seize.

3. ***Dealing with over-indebtedness: prevention and remedy measures.***

Managing the extreme household indebtedness problem means proposing a numerous set of distinct rules, necessary to encompass the different shapes of the problem. There is neither an unique field of Law nor a single rule that can secure the achievement of proper solutions. A so-called "Over-Indebtedness Consumer Act" would be a widening and heterogeneous set of rules related to a very large and heterogeneous aspect of the Law, without accurate incardination in the remainder of legal system. Instead of incorporating an unique and comprehensive solution, the legislator should take measures of very different nature in various fields of Law: consumer retail credit, electronic payment devices, on-line contracts, wager and game Law, individual seizure Law, collective insolvency proceedings, etc.

A theoretical approach would encompass an initial division between preventive measures, which attempt to avoid the indebtedness situation, and ex post remedial measures, which face up to the extreme indebtedness problem after the consumer puts himself in a financial breakdown situation.

a) *Preventive precontractual measures*. They attempt to prevent the consumer taking upon itself, in an imprudent way, debts payable in the future. Among these intended measures we like to highlight the following:

- Measures available to restrict creditor's liberty to issue consumer credit in aggressive marketing forms that diminish consumer endurance to the offer of credit. For instance, measures that fosters full disclosure of the credit conditions.

- Measures that set out as mandatory requirement the payment of a minimum down-payment, to obligate the debtor to face the real moment and the cost of its decision.

- Measures consisting in barring the perfection of credit contract in some conditions (i.e, domiciled credit contracts) or measures "closing" to the consumer some high risk market practices (i.e. borrowing under bills of exchange). The closeness of risky credit markets is, inter alia, an efficient way to prevent the extreme indebtedness.

- Measures intended to put the consumer in optimal conditions for taking a prudent decision on obtaining the credit. The more preliminary requirements to engage contracts the legal rule poses, more are the

chances that consumers reflects on its real needs and its payment means. Especially important are the different cooling-off periods. Throughout this device, consumer may realize that the initial reason to become debtor does not respond to any real need thereto.

- Measures that endorse creditors with the duty to deal in a responsible manner. For instance, burdening the creditor with the cost and responsibility to advice the debtor on the most convenient kind of credit, thus leaving up to creditors the risk to inform themselves on the financial conditions of the intended debtor, etc.

- Measures that prevent linked or subordinate contracts, when the consumer is put in the situation of taking up a credit when he wishes to celebrate another contract.

b) *Preventive contractual measures*. Were the consumer entered into a credit contract, these measures intend to implement a feasible way to keep the amount of the accrued indebtedness or the amount of the risk borne by the consumer as debtor or surety as low as possible.

- Limitation of the maximum amount to be credited to consumers or to be paid by consumer guarantors.

- Limitation of interest rates.

- Rights of wilful termination in open-ended credit contracts.

- Measures that make possible for the consumer to reimburse its debt in advance, saving the cost of the agreed initial time.

- Measures that deprive of legal effect any device that burdens in an unreasonable manner the consumer's position in case of non-performance; besides measures that permit the consumer not to take upon itself the risk of non-compliance of third party. Especially, legal means that make the consumer sure that purchase / service contract and credit contract are not isolated in order to harm the debtor.

c) *Remedial ex post measures*. In these cases, extreme indebtedness is at stake, and the purpose that remains is containing its effects thereof. These measures may be substantive or procedural ones:

- Normative settings of minimal patrimonial assets that should be free of creditor's seizure.

- Giving the debtor the possibility to resort to courts in order to get additional time to perform or to reconstruct or to refinance the debt. Likewise, cutting off legal effects to the automatic resolutive clauses favourable to creditors.

- Framing the insolvency collective procedure as a way not to liquidate the personal assets of the debtor, but to refinance and restructure the normal stream of future flows, in order to enable them to face a rational plan of payments.

- Making possible for the debtor to enjoy a fresh future start, liberating itself of the non paid amount of debts that remains due after the reorganization Plan is fully complied with.

- Barring private procedures of repossession of the sold or financed goods, if the breaching consumer has not agreed thereto.

4. ***Consumer Credit proposals.***

Extreme household indebtedness was not a topic worthy of consideration by the Directive 87/102/CEE. Notwithstanding the lack of express consideration, there were some rules that could be explained as a legal concern of the extreme indebtedness problem, and not only as applications of the policy of full precontractual disclosure in consumer contracts. For instance, the rule related to advertising (Article 3), the right of advance reimbursement (Article 8), the cooling off period (Annex i).

The European Commission thought probably that, due to lack of any real competence to impose consumer bankruptcy solutions, the best way to address the over-indebtedness problem remained the retail consumer credit field of Law, that in Draft/2000 did include some new provisions, some of them of the utmost relevance in the problem we face now.

The measures incorporated by the Proposal of Directive are as follows:

1) *Advertising*. Any advertising or any offer displayed at business premises that includes information on credit agreements, in particular regarding the borrowing rate, total lending rate and annual percentage rate of charge, shall be provided in a clear and comprehensible manner, with due regard, in particular, to the principles of good faith in commercial transactions. The commercial purpose of this information must be made clear (Article 4). Obviously, a better information level gets less the "compulsory" consumer's trend to get into credit.

2) *Ban of negotiation credit and surety agreements outside business premises.* The negotiation of a credit or a surety agreement outside business premises in the circumstances referred to in Article 1 of Council Directive 85/577/EEC shall be prohibited (Article 5). Especially important is this case because the most outstanding consumer credit problems recorded in Spanish Case Law stem from credit contracts negotiated in the consumer domicile or through non face-to-face contracts out of commercial premises.

3) *Exchange of information in advance and duty to provide advice.* Notwithstanding application of Directive 95/46/EC, and in particular Article 6 thereof, the creditor and, where applicable, the credit intermediary may

request of a consumer seeking a credit agreement, and any guarantor, only such information as is adequate, relevant and not excessive, with a view to assess their financial situation and their ability to repay. The consumer and guarantor shall reply accurately and in full to any such request for information. The creditor and, where applicable, the credit intermediary, shall provide the consumer with all the exact and complete information needed regarding the credit agreement under consideration. The consumer shall receive this information on paper or on any other durable form before the conclusion of the credit agreement. The information provided must included a concise and clear description of the product, its advantages, and any drawbacks. In particular the information must refer to: a) the sureties and insurance required; b) the duration of the credit agreement; c) the amount, number and frequency of payments to be made; d) the recurrent and non-recurrent charges, including additional non-recurring costs which the consumer has to pay on concluding a credit agreement, such as taxes, administrative costs, legal fees and assessment costs with regard to the sureties required; e) the total amount of credit and the conditions governing the drawdown of the credit; f) where applicable, the cash price of the financed goods or services, the down payment due and the residual value; g) where applicable, the borrowing rate, the conditions governing the application of this rate and any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions and procedures for varying the borrowing rate; h) the annual percentage rate of charge and the total lending rate, by means of a representative example mentioning all the financial data and assumptions used for calculating the said rates; i) the period during which the right of withdrawal may be exercised. The creditor or, where applicable, the credit intermediary shall seek to establish, among the credit agreements they usually offer or arrange, the most appropriate type and total amount of credit taking into account the financial situation of the consumer, the advantages and disadvantages associated with the product proposed, and the purpose of the credit.

It is worth mentioning the partial change of the indebtedness risk allocation, from the debtor to the creditor. For it is certainly a revolutionary idea to state that the risk of debtor’s insolvency is a risk to be borne by the creditor, which takes upon itself the heavy charge of gathering information and of informing the debtor on the real extent of its own financial decisions. If we were consistent with his approach, insolvency would appear as a consequence of the creditor’s failure to value the risk, not as a consequence of the debtor’s irresponsible conduct.

4) *Right of withdrawal* (Article 11). The consumer shall have a period of fourteen calendar days to withdraw his acceptance of the credit agreement without giving any reason. This period shall begin on the day a copy of the concluded credit agreement is handed over to the consumer. The deadline shall be deemed to have been observed if this notification, which must be on paper or on another durable form that is available and accessible to the creditor, is dispatched before the deadline expires. The consumer shall pay the interest due for the period during which credit was drawn, calculated on

the basis of the agreed annual percentage rate of charge. No other indemnity relating to withdrawal may be claimed. Any down payment effected by the consumer under the credit agreement shall be repaid to the consumer without delay.

The withdrawal right continues to be the best means to protect the debtor against its own imprudent financial decisions. Up to now, the cooling-off period remains the most important device for protection of the consumer.

5) *Responsible lending* (Article 9). If the creditor concludes a credit or surety agreement or increases the total amount of credit or the amount guaranteed, he is assumed to have previously assessed, by any means at his disposal, whether the consumer and, where appropriate, the guarantor can reasonably be expected to discharge their obligations under the agreement.

   Again, the indebtedness risk renders non-performance a "creditor's risk", by imposing on him the duty to check that consumer debtors do not become insolvent.

   In order for creditor to make the necessary assessment as to the credit worthiness of the consumer, Article 8 burdens States with the duty to gather and maintain a centralised database or network including the identity of the consumers who in the past have had defaulting experiences. The creditor or credit intermediary must check these data before concluding a credit contract; in case these creditors do not fulfil this duty, they lose the right to the credit interest (Article 31).

6) *Early Repayment* (Article 16) Consumer shall be entitled to discharge fully or partially his obligations under a credit agreement before the time fixed in the agreement. Any indemnity claimed by the creditor for early repayment shall be fair and objective and shall be calculated on the basis of actuarial principles. No indemnity shall be claimed.

   It is the essence of the right to anticipate reimbursement that debtor not only owns the right to make an early payment, but that the anticipation itself signifis a reduction in the cost of the issued credit. Creditors are not entitled to charge the original interest, and, additionally, cannot impose any penalty by losing a credit originally issued at a longer time.

7) *Surety contracts.* The Proposal applies also to sureties issued by a consumer, regardless of whether the underlying obligation is a consumer or a non-consumer debt. The surety contract must state the maximum amount guaranteed (Article 10.3). The surety contract should not extent more than three years when the credit-underlying contract is open-ended (Article 23.1). The amount guaranteed may only equal the outstanding balance of the total amount of credit and any arrears in accordance with the credit agreement, with the exclusion of any other indemnities or penalties provided for by the credit agreement (Article 23.3).

8) *Tying contracts* [Article 15 b)]. The Proposal bans the practice of "tying" or subordinating the perfection of the intended credit contract to the previous or simultaneous subscription of another non intended contract, wherever the cost thereof is not included in the cost of credit in consideration.

9) *Bill of exchange and other securities* (Article 18). Bills of exchanges accepted or drawn by consumers enhance the "illusion" of future easy repayment of actual debts. Besides, the way these documents circulate shields the third bearer in good faith from the exceptions raised by the debtor against the vendor or credit lender. Hence, and taking these dangers into considerations, the Proposal bans those payment devices.

10) *Advances in current accounts.* (Article 21). Where a credit agreement covers a credit in the form of an advance on a current account or debit account, the consumer shall be regularly informed of his debit situation by means of a statement of account, on paper or on another durable medium. Similarly in cases of temporary overrunning or tacit overdraft (Article 25).

11) The right to escape from the credit contract, when this is open-ended (Article 22).

12) *Limitation of remedies against the debtor* (Articles. 24 and 26). Creditors may not take disproportionate measures to recover amounts due to them in the event of non-performance of such agreements. The creditor may demand immediate payment in the event of default or invoke a clause providing an express resolutive condition only through a prior default notice requesting the consumer or, where applicable, the guarantor to comply with his obligations under the agreement within a reasonable period of time or to apply for rescheduling of the debt. In the case of credit agreements for acquisition of goods, and if the debtor does not give its consent to repossession of the goods, if he has already made payments corresponding to a third of the total amount of credit, the goods financed can only be repossessed by judicial proceedings. Member States shall further ensure that, where the creditor repossesses the goods, the account between the parties is made up to ensure that repossession does not entail any unjustified enrichment.

During the discussions held in the process of enactment of the Proposal of Directive, some of these measures have been undercut. Therefore, after Parliament's approval of the Directive, it results that:

- The standard information to be given before the contract is perfect was reformulated (Article. 4). This is also the case with the information to be given in a situation of advances in current account (Article 21).

- The intended regulation would not apply to credit contracts whose amount is lower than 500 €

- The ban to agree credit contracts from the creditor's business premises has disappeared (art. 5).

- Limitations to repossession of goods, laid down in Article 26 of the Proposal are suppressed.

- It has also disappeared the prohibition to "tied" or subordinated contracts.

- The creditor's duty to check with due accuracy the fitness and suitability of the credit condition of the consumer has been balanced and undercut with the debtor's own duty to make a responsible recourse to the credit (art. 6). The duty to provide advice also loses its general range of application ("*provide the consumer with all the exact and complete information needed regarding the credit agreement under consideration (…) including a concise and clear description of the product, its advantages, and any drawbacks"*) and is reduced to some specific items.

- Surety contracts agreed into by consumers come away of the intended regulation.

- There is no longer any duty to create a common debtors database. Each European Country shall guarantee access of alien creditors to databases located in its jurisdiction, in the same conditions provided to national creditors (art. 8).

- The fourteen days cooling- off period remain.

- It remains the possibility to anticipate reimbursement of the credit (art. 16).

5. ***Over-indebtedness and bankruptcy***

The Bankruptcy Law may deal with the extreme household problem in three ways. First of all, making possible a special insolvency proceeding, more fitted and suitable to the real needs and possibilities of debtors and creditors in consumer bankruptcy. Secondly, by providing anticipated workable devices to prevent the happening of the financial breakdown. In the third place, by setting a "final line" that enables the debtor to start afresh in the future, free of the burden of old unpaid debts. Apart from these consumer prospective singularities, nowadays Bankruptcy Law does not provide any measure other than the general stay of procedures and the moratorium on debts' collection.

However, it is difficult to think that the most appropriate place to resolve the above-mentioned problem might be bankruptcy proceedings. Neither debtors nor creditors have any real and credible incentive to converge to collective proceedings, unless the debtor has no other way to liberate himself of the remainder of the debts. Bankruptcy is expensive and time consuming. It lacks for all the interested parties the justification to bear the cost to develop a long process as such. Especially if we take into account that the consumer debtor will not normally have many creditors to negotiate with. Reduction of debts or moratorium of seizures could therefore be negotiated better in private agreements.

The new Spanish Bankruptcy Law enhances the insolvency solutions construed upon agreement of the interested parties, rather than through asset liquidation. However, unlike Germany or France, new Spanish Law contains no mention of consumer insolvency nor articulates any kind of cheap or easy procedure for getting through consumer insolvency proceedings. Although Bankruptcy Law has been nowadays founded upon the "uniqueness" rule, regardless of the commercial or private condition of the debtor, the real impression that stems from the Act is that most legal provisions have not any real sense for insolvent consumer debtors.